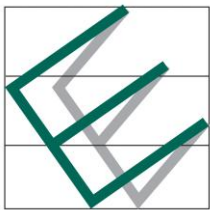
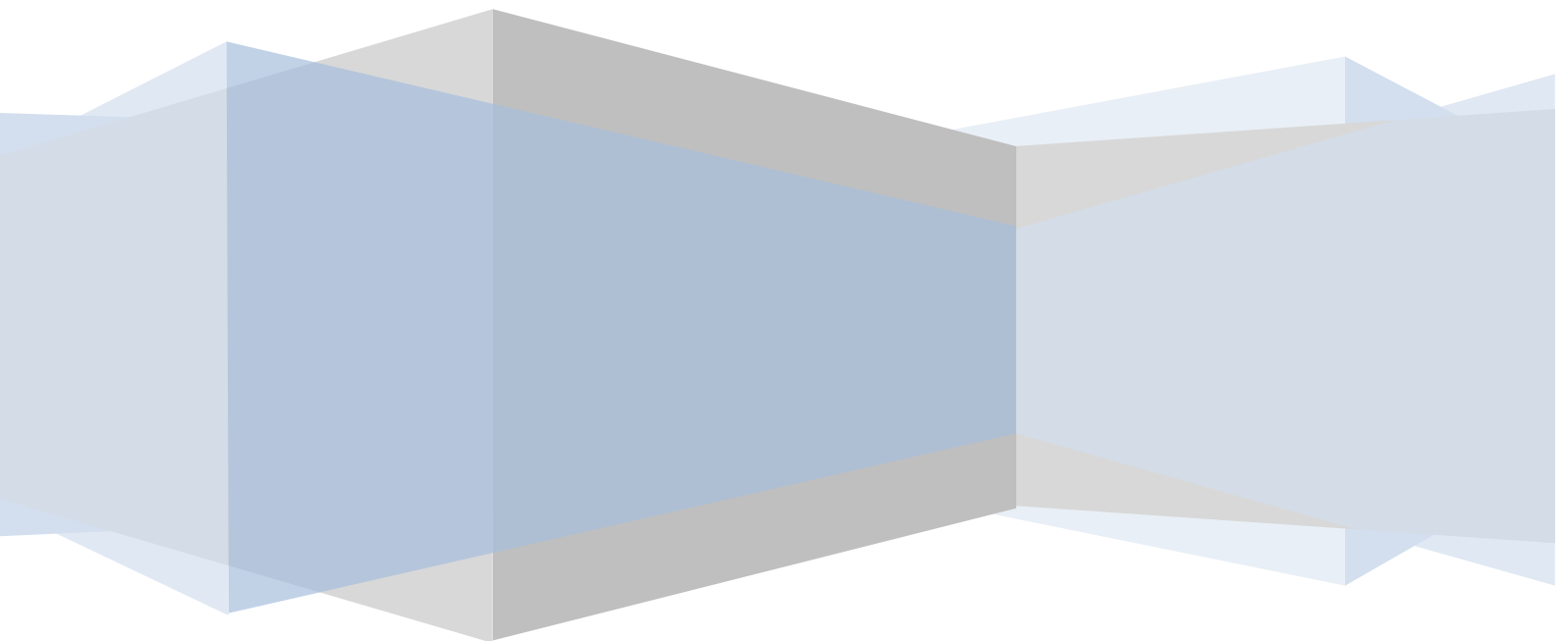


GEORGIA PERFORMANCE STANDARDS

Unit 3: “Markets – Not Just for Fleas and Stocks”



**Georgia Council on
Economic Education**



GEORGIA PERFORMANCE STANDARDS

SSEF3. The student will explain how specialization and voluntary exchange between buyers and sellers increase the satisfaction of both parties.

a. give examples of how individuals and businesses specialize

The division of labor refers to the practice that the tasks of producing a good or service are divided up into separate tasks. When workers focus on performing separate tasks, specialization occurs. Within a company, for example, there are typically workers who specialize in buying supplies, different aspects of production, future planning, paying bills and taxes, collecting sales revenue, hiring and managing workers, and many other categories. Within the economy as a whole, the division of labor explains why even if you bake your own bread, you typically don't grow your own wheat, grind it into flour, build your own oven, make your own bread-pans and so on. Instead, people specialize in a few skills and then take the wages that they earn from those skills to purchase the other goods and services that they desire from other specialists. In this way, the division of labor and specialization is the basis for an economy to exist.

Adam Smith started his classic book *The Wealth of Nations* with a discussion of the division of labor as the basis for understanding how an economy works. He identified three reasons why the division of labor increases output: workers who specialize on one job become much better at doing it; with specialization, the time that it would take to switch between jobs is eliminated; and workers who specialize on one job often invent more effective ways or new machines for doing the job. But as Adam Smith makes clear, specialization is possible only when people are able to coordinate their production and consumption decisions with each other. The study of economics is largely concerned with explaining how this coordination takes place.

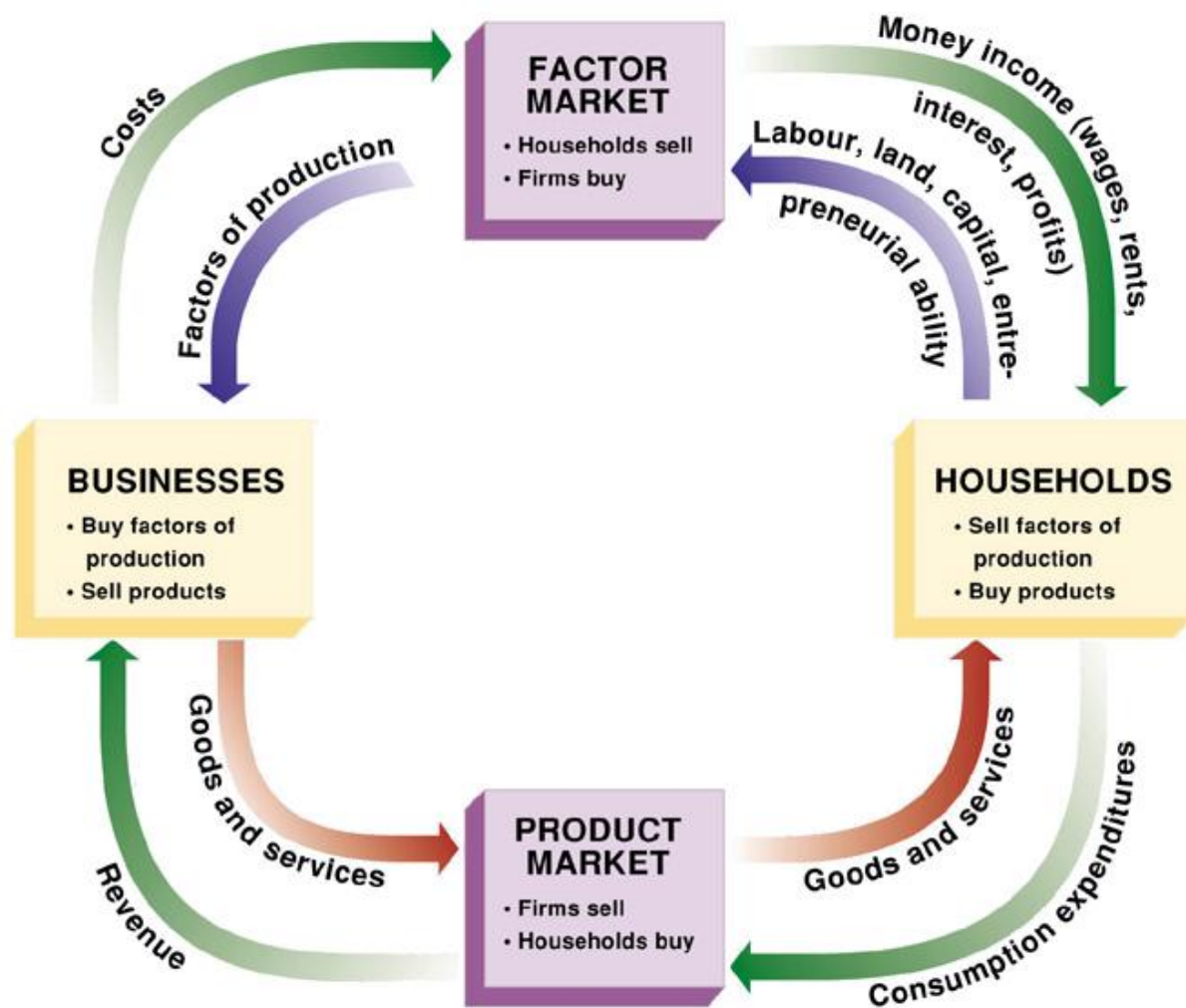
b. explain that both parties gain as a result of voluntary, non-fraudulent exchange.

People do not make everything that they and their family use: that is, they do not grow all their own food, sew their own clothes, build their own house and provide themselves personally with health care and education. Instead, people focus on a particular job and then use the wages that they earn from that job to purchase the goods and services they desire. In this way, an economy forms an interlinked network of trade, exchange and interdependence.

Specialization is the basis of trade and interdependence among individuals, cities, regions and countries. Most countries do not produce all of what they consume. Instead, they focus more heavily on producing certain products and trading with other countries. Thus, the global economy is a network of trade and interdependence. When trade is voluntary and non-fraudulent, both parties in the trade gain.

SSEMI1 The student will describe how households, businesses, and governments are interdependent and interact through flows of goods, services, and money.

a. Illustrate by means of a circular flow diagram, the Product market; the Resource (factor) market; the real flow of goods and services between and among businesses, households, and government; and the flow of money.



b. Explain the role of money as a medium of exchange and how it facilitates exchange.

Money

Anything that is used to buy and sell *goods* and *services*. Money has three functions. First, it is a *medium of exchange*, which means that it is generally accepted as payment for goods and services. Second, it is a *store of value*; that is, it retains its value at least over periods of days and months. Third, it is a *unit of account*, so that values are measured in units of money. In different times and places, many different items have served these three functions of money: gold, silver, shells, cattle, tobacco and printed paper currency. Today individuals, businesses and governments often use deposits in checking and similar accounts as money.

SSEMI2 The student will explain how the Law of Demand, the Law of Supply, prices, and profits work to determine production and distribution in a market economy.

a. Define the Law of Supply and the Law of Demand.

Law of Supply

A microeconomic law stating that, all other factors being equal, as the price of a good or service increases, the quantity of goods or services offered by supplier's increases and vice versa.

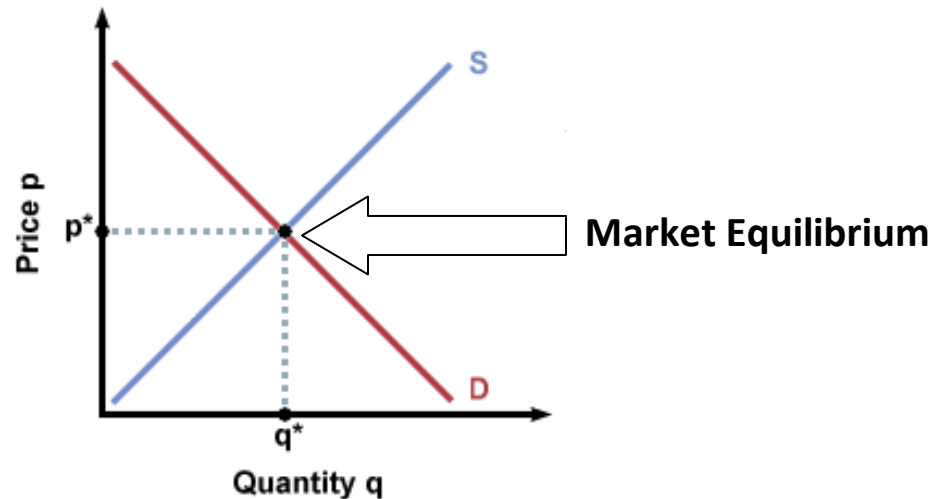
Law of Demand

A microeconomic law that states that, all other factors being equal, as the price of a good or service increases, the quantities consumers demand for the good or service will decrease and vice versa.

b. Describe the role of buyers and sellers in determining market clearing price.

The market clearing price or equilibrium price "clears" the market resulting in a situation where there are neither shortages nor surpluses. Transactions in a market economy are voluntary so they must benefit both buyers and sellers.

c. Illustrate on a graph how supply and demand determine equilibrium price and quantity.



d. Explain how prices serve as incentives in a market economy.

The price is the amount of money needed to buy a particular good or service. In a market, the price and quantity exchanged are determined by the interaction of demand and supply. Changes in demand or supply alter the equilibrium price as well as the quantity bought and sold at that price. Prices provide incentives to both buyers and sellers. For example, if poor weather in Brazil causes a reduction in the supply of coffee and an increase in the price of coffee, then at least some buyers of coffee will react to the higher price by reducing the amount of coffee they drink or by substituting some other drink. If the demand for fresh fruits and vegetables increases, causing the price to rise, then at least some suppliers will react to the higher price by producing more. In this way, flexible and adjustable prices are messengers in a market economy, revealing information on supply and demand conditions and providing incentives for market participants to respond appropriately to that information.

Prices could be considered Adam Smith's "invisible hand" that brings the actions of self-interested individuals in harmony with the general prosperity of a society. Flexible prices bring the interests of consumers and producers together.

SSEMI3 The student will explain how markets, prices, and competition influence economic behavior.

a. Identify and illustrate on a graph factors that cause changes in market supply and demand.

Factors that cause changes in market supply

Cost of inputs

Productivity

Technology

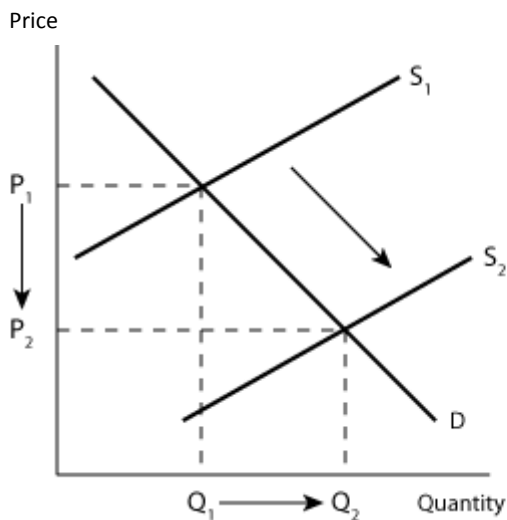
Taxes and Subsidies

Expectations

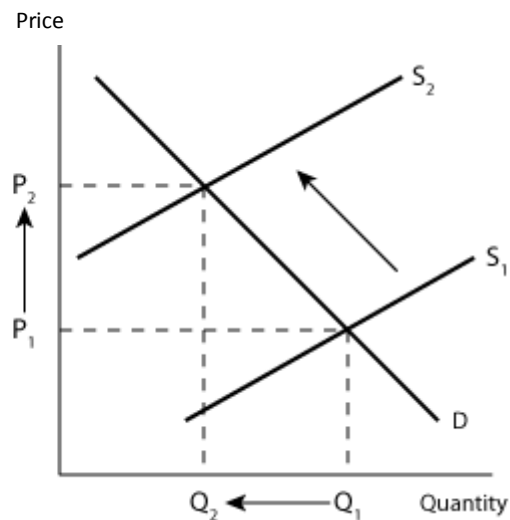
Government regulations

Change in the number of sellers

Weather/natural disasters



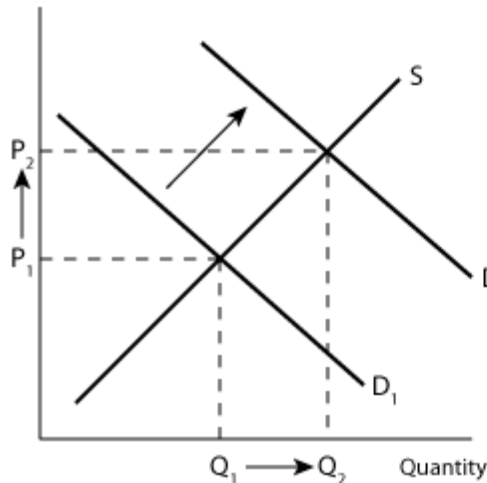
Increase in Supply



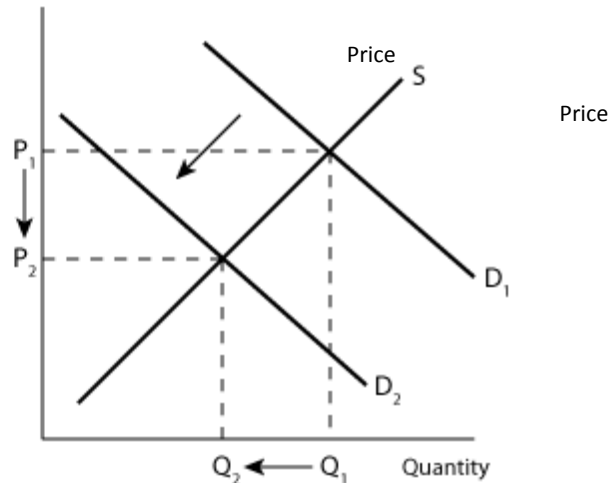
Decrease in Supply

Factors that cause changes in market demand

Consumer income/wealth
Consumer tastes and preferences (advertising)
Change in the price of substitute goods
Change in the price of complementary goods
Change in expectations
Change in number of consumers



Increase in Demand



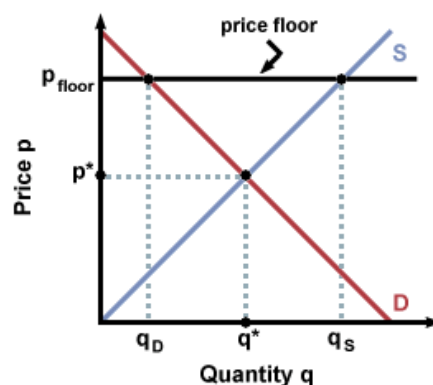
Decrease in Demand

b. Explain and illustrate on a graph how price floors create surpluses and price ceilings create shortages.

Price floor

A price floor is a legally established minimum price. Governments enact price floors when they fear that the price might be lower than they desire it to be. Examples of price floors include farm products and the minimum wage. When a price floor is higher than the market price that would otherwise prevail, the result is that quantity supplied in the market (which is encouraged by the higher price) exceeds quantity demanded (which is discouraged by the higher price). Economists call this outcome a surplus.

One unintended consequence of a price floor is that although the price floor is meant to benefit providers of the good or service, it creates a situation in which some of those providers won't be able to sell their goods or services. This is because at the price floor, an insufficient quantity is demanded. With farm price supports, the government has often stepped in to purchase the surplus products. With minimum wage laws, a basic concern is that although the minimum wage will help those who continue to keep their job, it will injure those who lose a job (or are not hired or are hired for fewer hours) as a result of the minimum wage.



Price ceiling

A price ceiling is a legally established maximum price. Governments enact price ceilings when they fear that the price might be higher than they desire it to be. Examples of a price ceiling are rent-control laws that limit the rent that can be charged (or limit the increase in rents from year to year). When a price ceiling is lower than the market price that would otherwise prevail, the result is that quantity demanded in the market (which is encouraged by the lower price) exceeds quantity supplied (which is discouraged by the lower price). Economists call this outcome a shortage.

One unintended consequence of a price ceiling is that although the price ceiling is meant to make the good more affordable and benefit consumers, it instead creates a situation in which some of those who demand the good won't be able to buy it at all. A second implication is that price ceilings open up incentives for an illegal market, which refers to sales which happen at an illegal price.



c. Define price elasticity of demand and supply.

Price elasticity of demand

The way of measuring how much quantity demanded will change in response to a change in price.

Price elasticity of supply

The way of measuring how much quantity supplied will change in response to a change in price.

SSEMI4 The student will explain the organization and role of business and analyze the four types of market structures in the U.S. economy.

a. Compare and contrast three forms of business organization—sole proprietorship, partnership, and corporation.

Sole proprietorship

A business owned and run by one person.

Advantages- ease of start-up, ease of management, owner can enjoy all profits, owner has full control, easy to discontinue, *business* itself is exempt from tax on income.

Disadvantages- unlimited liability (owner is personally and fully responsible for all losses and debts of business), difficulty of raising financial capital, amount of work for one person may be overwhelming, limited life.

Partnership

A business jointly owned by two or more people.

Advantages- ease of start-up, each partner brings a unique skill to the partnership, larger pool of capital, lack of special taxes on partnership itself.

Disadvantages- each partner is fully responsible for partner, unlimited liability for partnerships that are not limited liability partnerships (LLP), limited life, potential for conflict with partners.

Corporation

A business organization that is owned by stockholders and recognized by law as a separate legal entity having all the rights as an individual.

Advantages- ease of raising financial capital through the sale of stock or the issuance of bonds, limited liability for owners, unlimited life, ease of transferring ownership.

Disadvantages- difficult to start, owners/shareholders often have little say in how the business is run, many more legal requirements and regulations, double taxation.

b. Explain the role of profit as an incentive for entrepreneurs.

Entrepreneurs are willing to risk their own resources in order to sell them for financial gain or profits. Entrepreneurs are successful when they provide consumers with goods and services that consumers highly value. Financially successful entrepreneurs have some common characteristics. First, they are willing to assume risk, and high risk can lead to high rewards. Second, entrepreneurs have unique skills that help them develop new products or new cost-cutting production methods or new ways to serve consumers. Third, many entrepreneurs also have the discipline to work long and difficult hours to achieve their goals. These same entrepreneurial characteristics can help anyone to be successful even one who doesn't start a business. If you want to earn more income, develop valuable skills and use them in ways that are highly valued by others.

c. Identify the basic characteristics of monopoly, oligopoly, monopolistic competition, and pure competition.

Monopoly

A market structure in which there is a single supplier of a good or service. Also, a firm that is the single supplier of a good or service for which there are no close substitutes; also known as a monopolist.

Oligopoly

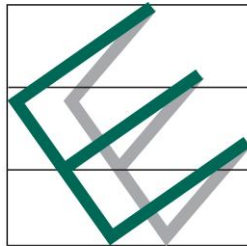
A market structure in which a few, relatively large firms account for all or most of the production or sales of a good or service in a particular market, and where barriers to new firms entering the market are very high. Some oligopolies produce homogeneous products; others produce heterogeneous products.

Monopolistic competition

A market structure in which slightly differentiated products is sold by a large number of relatively small producers, and in which the barriers to new firms entering the market are low.

Pure competition

A market structure in which a large number of relatively small firms produce and sell identical products and in which there are no significant barriers to entry into or exit from the industry. Firms in perfect competition are price takers and in the long run will earn only normal profits.



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